The DFI Update

Periodic Publication of The Indiana Department of Financial Institutions
VOLUME VI1-1999

The DFI Update
Department of Financial Institutions

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INSIDE

CSBS OFFERS SCHOOLS TO BANKERS

The Conference of State Bank Supervisors ("CSBS") is widely known as the professional association of the state banking departments and state chartered banks throughout the nation. For many years, CSBS has been a main source of examiner training, offering various schools ranging from bank operations to executive level programs. The schools are being made available to commercial bankers and other financial services industry personnel. CSBS classes may be ideal to supplement existing training programs for all levels of bank employees. They provide very constructive hands-on instruction on a variety of crucial banking issues.

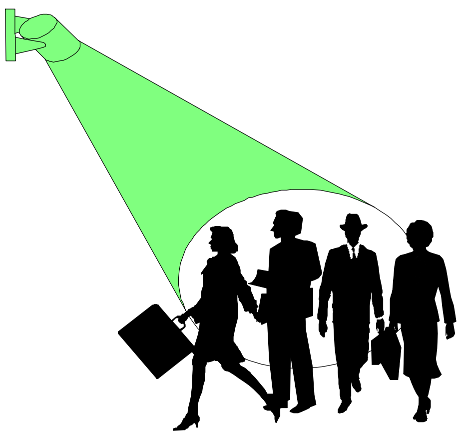
Most classes are one week in duration and are held in Dallas, Texas, although some will be held in Cincinnati and Portland. Classes are designed and instructed by senior supervisory personnel culled from the premier banking departments in the country.

Listed below are classes offered by CSBS for 1999, with a brief description. If you have any questions about the classes, contact Cynthia Hunt at 214/357-6690.

Start Date	Class Name	Description	Price
August 9-12	**School of Hard Knocks** (Dallas)	This course examines the systematic causes that led to the financial industry's crises of the 80's and 90's. This is not an advanced loan analysis course. Covering all five areas of crises, agriculture, commercial real estate, oil, fraud and the thrift industry, the course will: • Review and analyze past regulatory, legislative, and banking strategies and tactics • Identify the red flags and lessons learned • Attempt to answer the questions: How can/will it happen again? How can we spot developing problems and solve, or temper them?	$725.00
August 16-20	**Credit Evaluation School** (Dallas)	This school teaches students to evaluate credit risk and its effect on a bank, and to determine management effectiveness in managing credit risk. This program also enhances oral and written communication skills. At the completion of the school, the student will be able to: • Categorize types of loans • Identify types of credit risk • Identify violations of basic credit-related regulations • Identify documentation requirements for loans • Identify components of effective credit policies and procedures • Apply effective communication skills to loan discussions/write-ups • Evaluate overall credit risk in a bank	$695.00

August 23-27	**Bank Operations School** (Dallas)	This school strengthens the student's understanding of the operational/accounting functions of a commercial bank and provides a better understanding of the fundamentals of an examination report. At the completion of the school, the student will be able to: • Prepare an investment schedule • Identify basic risk management concepts • Identify and categorize income and expense accounts • Prepare an earnings report page • Prepare bank-only and consolidated statements of condition • Assign preliminary component CAMELS ratings based on external sources • Complete the capital calculations page in the report of examination	$695.00
August 29- September 2	**Technology Conference** (Cincinnati)	This conference is your opportunity to learn and discuss current technology issues that not only affect day-to-day business operations, but also impact the financial industry, banking departments, and the regulatory process. The conference features: • Analysis of operational risk in electronic banking • Outlining security issues of electronic data and personal financial information • Demonstrating automated state and federal regulatory platforms • Writing a strategic IT plan • Exploring technology advancements for on-site and off-site staff • The future of the web	$595.00
September 27- October 1	**Bank Financial Analysis School** (Portland)	This school explains the principles of bank financial analysis-levels, trends, ratio analysis, and introduces the primary means of relating the bank examiner's findings-CAMELS ratings. This school improves students' writing skills by stressing the need to draw meaningful conclusions, to decrease over-reliance on numbers and peer groups, and to eliminate "canned" comments. Students strengthen their analysis skills by reviewing all ratios on the UBPR, without relying solely on a few ratios.	$695.00

October 18-22	**Fundamentals of Fiduciary Activities** (Dallas)	This school benefits individuals who have fewer than twelve months experience in fiduciary activities or trust examinations. It gives others an understanding of fiduciary concepts. The school is also recommended trust companies or bank trust departments. At the completion of the school, students will be able to: • Apply fundamental principles to determine an institution's compliance with laws, regulations, and sound fiduciary principles • Participate in the assessment of overall supervision, administration, and operations of fiduciary activities • Participate in the evaluation of adherence to policies, procedures, and monitoring systems of the institution • Participation in assigning the ratings described by the Uniform Interagency Trust Rating System	$695.00



EMPLOYEE SPOTLIGHT

This section of *The DFI Update* highlights some of the roles and achievements of the Department's employees.

Congratulations to the following employees whom have received promotions!

JANICE DAVIS-Janice was promoted to a PAT V on March 5, 1998.

VERNITA EARLY-Vernita was promoted to a FIE III on April 1, 1998.

AMANDA BRANDT-Amanda was promoted to a FIE III on May 4, 1998.

FRAN TATA-Fran was promoted to a FIE I on May 8, 1998.

ROBIN UPCHURCH-Robin was promoted to a FIE II on May 13, 1998.

SARAH ZILIAK-Sarah was promoted to a FIE III on May 18, 1998.

JAN RILENGE-Jan was promoted to a PAT V on June 15, 1998.

ROD KLINGLER-Rod was promoted to a FIE III on September 21, 1998.

SCOTT SHELTON-Scott was promoted to a FIE III on October 19, 1998.

TRACY BAKER-Tracy was promoted to an Administrative Assistant VI on March 31, 1999.

SCOTT ARMSTONG-Scott was promoted to a FIE III on May 31, 1999.

TONY BELL**-Tony was promoted to a FIE III on May 31, 1999.***

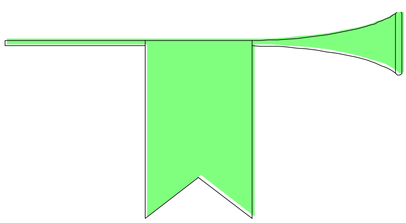
STEVEN WACHTER**-Steve was promoted to a FIE I on August 9, 1999.***

ANDREW WARD**-Andy was promoted to a FIE I on August 9, 1999.***

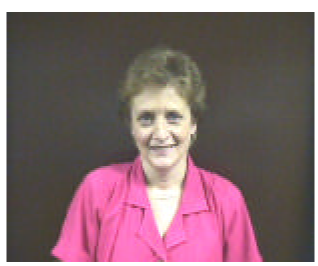
JACOB SWANSON**-Jacob was promoted to a FIE I on August 9, 1999.***

ANDREA HEMMIG**-Andrea was promoted to FIE III on August 9, 1999.***

The Department would like to congratulate Steve Wachter on his marriage to Stephanie Seashore. The wedding was held at College Park Baptist Church on June 19, 1999. Mr. and Mrs. Wachter reside in Speedway, Indiana. Best Wishes!

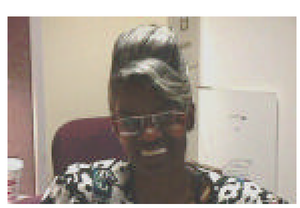


WE ARE PLEASED TO WELCOME TO THE DFI…



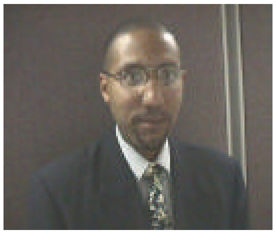
BARBARA COLE

…came to the Department of Financial Institutions, the Bank and Trust Division as a Secretary III, on May 17, 1999. Barbara worked as a Secretary III for two and a half years at the Indiana Department of Insurance and specifically worked as a Secretary III for the Chief Counsel. She worked for the State Department of Health also. Barbara's hometown is Indianapolis, Indiana, and that is where she currently resides with her family.



JUDY JONES

…came to the Department of Financial Institutions, the Administration Division, as a Secretary III/Receptionist, on July 19, 1999. Judy worked as a Secretary IV for three years at the Department of Workforce Development in Technical Education. Judy is very active with her church and serves on many committees. Judy resides in Indianapolis.



CHRIS MCKAY

…came to the Department of Financial Institutions, Administration Division, as a summer Intern from I.U. School of Law, Indianapolis. Chris works under Phil Goddard's direction. Chris is a third year student at I.U. School of Law, Indianapolis. Chris is the Secretary of the Indiana University/Indianapolis International Law Society and the co-founder of the Sports and Entertainment Law Society. Chris' hometown is Brooklyn, New York, and he currently resides in Indianapolis.

KEVIN ROUNDS

…came to the Department of Financial Institutions, Bank and Trust Division, as a summer Intern from Marian College. Kevin works under James Cooper's direction. Kevin is a second year student at Marian College, Indianapolis, Indiana. His special interest is running cross country. Kevin currently resides in Greenwood, Indiana.

BANKING ACTIVITY

The Department of Financial Institutions recently issued no objection letters for two new banking activities requested by state chartered financial institutions. One addressed the issue of state chartered banks purchasing a minority interest in a limited liability company and the other addressed a bank’s formation of a subsidiary to serve as a captive insurance company.

NONCONTROLLING INTEREST IN A LIMITED LIABILITY COMPANY

In the first request, it was determined that a bank could hold a minority interest in a limited liability company ("LLC") which engaged in an activity that is permissible or incidental to banking. In this case, the limited liability company was to serve as agent for the issuance of and sale of real estate title insurance and ancillary services and products common to, or related to, the providing of real estate title insurance. To qualify as a permissible investment, the activities conducted by the LLC at all times must be permissible for the bank as long as the bank has an ownership interest in it. The operating agreement gave the bank the ability to prevent the LLC from engaging in activities not permissible for banks. The bank's loss exposure must be limited, as a legal and accounting matter, and the bank must not have open-ended liability for the obligations of the LLC. The operating agreement also limited the bank's liability for losses to the amount of its investment. Finally, the investment must be convenient or useful to the bank in carrying out its business and not a mere passive investment unrelated to that bank's banking business. Indiana Code 28-1-11-3.1(a) states that a bank has the power to exercise all powers incidental and proper or which may be necessary and usual in carrying on general banking business. Banks are granted the authority to solicit and act as agent for the sale of title insurance in Indiana Code 28-1-11-2. The investment in the LLC is a convenient and useful vehicle for the investing bank to conduct its banking business.

SUBSIDIARY TO SERVE AS A CAPTIVE INSURANCE COMPANY

In the second request, a bank requested permission to form a subsidiary to engage in the reinsurance of mortgage guaranty insurance on loans originated or purchased by the bank or the bank's lending affiliates. The subsidiary will assume only an excess layer of risk on insured loans. Generally, under an excess layer arrangement, the primary insurer will pay, and is solely responsible for, claims arising out of the book of business up to a predetermined level, after which the reinsurer (subsidiary) will be obligated to reimburse the primary insurer's claims up to another predetermined level. Thereafter, the primary insurer will be solely responsible for the claims.

The subsidiary will be liable, to the extent provided in the reinsurance agreement, to the primary insurer when an insured loan covered by the agreement goes into default. Therefore, the subsidiary's maximum exposure will be limited to an exact percentage of the mortgage insurance risk on each loan or on a pool of loans. The bank's potential liability for the subsidiary's reinsurance obligation will not exceed the bank's investment in the subsidiary. Finally, the subsidiary will not reinsure insurance on mortgage loans that have not been originated or purchased by the bank or its lending affiliates pursuant to its established underwriting and credit standards, and will not underwrite the insurance as a primary insurer.

In deciding whether to permit a subsidiary of a state chartered financial institution to engage in the reinsurance of mortgage guaranty insurance, the Department considered the bank's description of the activity to be conducted, whether the exercise of the activity is incidental and proper to the business of banking or may be necessary and usual in carrying on general banking business. Indiana Code 28-1-11-3.1(a) gives banks the authority to lend money. As such, banks assume credit risk. The bank could make or purchase a mortgage loan with little or no equity, if in the bank's underwriting judgement the return in the form of interest and fees justified the assumption of the additional risk associated with the lack of equity. The risk that is assumed by the subsidiary through its participation in the proposed mortgage guaranty reinsurance program is analogous to other credit risk that is assumed by the bank and it is incidental to and facilitates the general business of banking. The subsidiary's proposed activity is functionally equivalent to a partial repurchase of the bank's own loans, which is a permissible activity for state banks in Indiana.

…Gina Willliams

Joint Examination with the State Bank of Pakistan Examiners

PAKISTAN BANK EXAMINERS JOIN DFI STAFF

The Department of Financial Institutions is providing technical bank examination training to two Pakistan bank examiners affiliated with the State Bank of Pakistan. This effort is part of a larger training initiative provided by the Center for International Agricultural Finance at Iowa State University. A three-week training course in the U.S. has been developed for eighty Pakistan bank examiners. The Center for International Finance has been developing training programs in the areas of banking and law since 1989 and has hosted participants from 24 countries at ISU. State and federal agencies participating in the training program consist of the OTS, Minnesota, Missouri, and Kansas in addition to Indiana.

The Pakistan examiners have joined the DFI examination staff conducting an on-site examination during the period of May 10 through May 19. A key component of the training program is the seven days spent with bank examiners while in the U.S.

YEAR END FINANCIAL RESULTS

From December 31, 1997, to December 31, 1998, the number of state chartered commercial banks, state chartered stock and mutual savings banks, and active industrial authorities declined from 152 to 138, a 9.21% decrease. During the same period, total supervised assets decreased slightly from $26.3 billion to $25.4 billion, a 3.49% decrease. As of December 31, 1998, state chartered banks represented 34.2% of total Indiana bank assets (state and national). In contrast, state chartered banks represented 78.4% of the number of institutions in Indiana.

During 1998, three new state chartered commercial banks were opened. Seventeen state bank charters were eliminated through mergers with other state or national banks. Two state chartered mutual savings and loan associations converted to federally chartered savings and loan associations.

Indiana state chartered banks remained stable in financial condition and performance during the calendar year 1998. Net income declined slightly from $303 million recorded for calendar year 1997 to $298 million for year end 1998. Net income as a percentage of average assets increased slightly 1.25% to 1.26 %. The sustained performance of net income is the result of solid loan growth while maintaining good asset quality. The aggregate allowance for loan and lease losses (ALLL) during 1998, was decreased to 1.37% of total loans from 1.39% in 1997, and net charge-offs slightly increased from 0.20% to 0.21% of total loans. Although equity capital decreased from 9.41% to 9.16% of total assets from year end 1997 to year end 1998, capital remains at an adequate level.

The trend analysis utilized the following consolidated balance sheet, consolidated income statement and ratio analysis for all state chartered commercial banks, savings banks, active industrial authorities and national commercial banks. Information to compile these schedules was obtained through the Federal Reserve System's National Examination Database.

ACCOUNT DESCRIPTIONS *(IN MILLIONS OF $)*	State 12/31/98	National 12/31/98	State 12/31/97	National 12/31/97	State 12/31/96	National 12/31/96
Number of Banks	138	38	152	42	163	51
Income Statement						
Total Interest Income	1,780	3,121	1,910	2,986	1,917	3,021
Total Interest Expense	850	1,470	918	1,328	914	1,351
Net Interest Income	929	1,650	992	1,658	1,003	1,669
Total Non Interest Income	233	1,052	212	531	205	631
Loan Provisions	55	141	55	125	56	82
Total Non Interest Expense	661	1,632	690	1,228	719	1,255
Net Income	298	632	303	555	284	626

Ratio Analysis

Net Income to Average Assets	1.26%	1.58%	1.25%	1.42%	1.13%	1.58%
Net Income to Year End Total Equity	12.81%	14.90%	12.23%	17.51%	11.76%	17.46%
Net Interest Income to Average Assets	3.93%	4.12%	4.08%	4.24%	3.98%	4.21%
Total Loans to Total Deposits	82.84%	98.24%	83.17%	93.23%	80.28%	92.61%
Loan Loss Provisions to Total Loans	0.32%	0.41%	0.31%	0.44%	0.32%	0.28%
Loan Loss Reserves to Total Loans	1.37%	1.39%	1.39%	1.53%	1.42%	1.50%
Net Charge-Offs to Total Loans	0.21%	0.38%	0.20%	0.42%	0.22%	0.46%
Total Equity Capital to Total Assets	9.16%	8.68%	9.41%	7.62%	9.12%	8.66%
Total Equity Capital and Reserves to Total Assets and Reserves	9.98%	9.56%	10.25%	8.58%	9.97%	9.62%

ACCOUNT DESCRIPTIONS *(IN MILLIONS OF $)*	State 12/31/98	National 12/31/98	State 12/31/97	National 12/31/97	State 12/31/96	National 12/31/96
Number of Banks	138	38	152	42	163	51

Balance Sheet

Trading Accounts	20	8	26	48	0	16
Interest Bearing Balances	168	495	155	257	125	153
Fed Funds Sold/Repurchase Agreements	737	1,512	739	1,914	607	1,470
Securities Held to Maturity	1,189	196	1,450	337	1,642	411
Securities Available for Sale	4,383	6,226	4,397	6,422	4,685	5,808
Total Securities	5,572	6,422	5,847	6,759	6,327	6,219
Total Loans	16,931	34,263	17,732	28,569	17,440	29,057
Total Earning Assets	23,428	42,700	24,499	37,547	24,499	36,915
Total Assets	25,407	48,881	26,324	41,562	26,461	41,386
Average Assets	23,614	40,028	24,332	39,117	25,218	39,608
Total Deposits	20,437	34,876	21,320	30,643	21,723	31,374
Total Liabilities	23,079	44,638	23,846	38,392	24,046	37,801
Total Equity Capital	2,327	4,243	2,477	3,169	2,414	3,585
Loan Valuation Reserves	232	476	246	436	248	437
Total Equity Capital & Reserves	2,559	4,719	2,723	3,605	2,662	4,022
Total Other Real Estate	9	19	9	12	17	18
Total Charge-Offs	52	190	51	185	58	192
Total Recoveries	17	60	16	65	20	59
Net Charge-Offs	35	130	35	120	38	133

……..Kirk Schreiber

FFIEC ADOPTS UPDATED UNIFORM RATING SYSTEM FOR INFORMATION TECHNOLOGY

On June 9, 1998, the FFIEC published a notice in the Federal Register requesting comment on proposed revisions to the Uniform Interagency Rating System for Data Processing Operations. This rating system is an internal supervisory examination rating system used by federal and state regulators to assess uniformly financial institution and service provider risks introduced by information technology and for identifying those institutions and service providers requiring special supervisory attention. The current rating system was adopted in 1978 and is commonly referred to as the IS rating system. Under the IS rating system, each financial institution or service provider is assigned a composite rating based on an evaluation and rating of four essential components of an institution's information technology activities. These components address the following: the adequacy of the information technology audit function; the capability of information technology management; the adequacy of systems development and programming; and the quality, reliability, availability and integrity of information technology operations. The composite and component ratings are assigned on a "1" to "5" numerical scale. A rating of "1" indicates the strongest performance and management practices, while "5" indicates the weakest performance and management practices; therefore, the highest degree of supervisory concern. The IS rating system has proven to be an effective means for the federal and state supervisory agencies to assist examiners in determining the condition of an institution's or service provider's information technology function. A number of changes, however, have occurred in information technology and in supervisory polices and procedures since the rating system was first adopted. As a result the FFIEC is renaming the rating system to the Uniform Rating System for Information Technology (URSIT) and making certain enhancements to the rating system, while retaining its basic framework. *The effective date for supervisory agencies to begin using the URSIT rating system is April 1, 1999.* The URSIT enhancements include:

- Realigning the URSIT rating definitions to bring them in line with UFIRS
- Replace the current "Systems Development and Programming" and "operations" components with two new component categories, "Development and Acquisition" and "Support and Delivery."
- Reinforce the importance of risk management processes within the language in each of the rating components emphasizing the consideration of processes to identify, measure, monitor, and control risks.

For additional information see the FDIC web site, www.fdic.gov/banknews/fils/fil9912, or request paper copies through the FDIC's Public Information Center, 801 17th Street, NW, Room 100, Washington, DC 20434.

……Troy Pogue

Year 2000 Update

Efforts continue to ensure Indiana's financial system will make a smooth transition into the next century. Year 2000 reviews for each state chartered financial institution will be ongoing throughout the remainder of the year. These will focus on testing results; business resumption planning; liquidity issues; customer awareness programs; and weaknesses identified in previous reviews.

The financial industry continues to lead the way toward Year 2000 preparedness. The overwhelming majority of Indiana chartered financial institutions remain well prepared to meet the challenges posed by the century date change. This is also the case on the national level.

Internally, the Department is finalizing a strategic plan to overcome unexpected problems that may be encountered. The Department is working closely with federal regulators and other state agencies to ensure communication among the agencies and with the financial institutions. The plan will provide procedures to respond to various unanticipated problems that may be encountered leading up to and following the century date change. While fulfilling its civic responsibility to be prepared, the Department remains confident the transition to the new millennium will be relatively uneventful.

…………Troy Pogue

LEGISLATIVE UPDATE

HOUSE BILL 1597

A Department drafted bill authored by Representatives Oxley II, Bodiker, Burton and Whetstone in the House and sponsored by Senator Paul in the Senate has passed both the House and Senate by wide margins. The bill became law on July 1, 1999.

This bill contains several technical amendments to accommodate changes in the banking environment. The bill provides revised and liberalized regulations for financial institution operating subsidiaries. This amendment which applies to all state chartered financial institutions alters the definition of a subsidiary to allow for ownership of less than eighty percent (80%). Specifically, any foreign or domestic corporation or limited liability company in which a financial institution has more than fifty percent (50%) ownership, will be defined as a "Qualified subsidiary" and must file notice with the Department. Any foreign or domestic corporation or limited liability company in which a financial institution has fifty percent (50%) or less ownership, will be defined as a "Non-qualified subsidiary" and must submit an application and receive approval from the Department. This amendment limits the activities of a subsidiary to those activities permitted for a financial institution, those activities authorized by 12 CFR 5.34, or to those activities incidental to the business of banking.

The bill clarifies existing law to allow the articles of association or articles of conversion to define the voting rights for the members of mutual savings associations and mutual savings banks. If the articles of association or articles of conversion have not established the rights of its voting parties for a mutual savings association or a mutual savings bank, a member or shareholder is entitled to cast one (1) vote for each one hundred dollars ($100) of deposits and each borrower is entitled to cast (1) vote as a borrower.

The legislation will allow a financial institution organized under the laws of any state or the United States to establish a branch office using a name other than the name of its home office. This amendment does not provide for assumed names of financial institutions.

The bill amends IC 28-1-20-1.1 which deals with service and maintenance charges on dormant accounts. The statute was changed to eliminate the requirements for the Department to establish dormant account fees. Under this statute, it will be the responsibility of the financial institution's board of directors to establish the dormant account charge and to properly disclose this fee to its depositors. As a result of these changes, 750 IAC 2-4-1 and 750 IAC 2-4-2 were also repealed.

House Bill 1597 also contains some technical amendments that: clarifies a corporate fiduciary's authority to sell life insurance; gives the Department authority to exercise enforcement powers against a person or entity that improperly holds itself out as a financial institution; gives the Department authority to exercise its enforcement powers against affiliates if the practice of the affiliate causes "substantial loss" or the interests of the financial institution's depositors are "seriously prejudiced"; and updates all references to federal law or regulations to January 1, 1999.

HOUSE BILL 1715

The non-depository division of the Department has been involved in the drafting of House Bill 1715. This bill has the following provisions: specifies that the maximum rate of interest may not be exceeded upon prepayment for the period a credit sale or loan was in effect for a simple interest transaction that includes prepaid credit service charges or finance charges; requires a creditor to provide accurate payoff information to the debtor; specifies that a person may not regularly engage in the business of making consumer loans unless the person is a supervised financial institution or is licensed by the Department; specifies that the three month window to operate without an approved license to consumer loans applies only to lenders taking assignment of mortgages; adds a small loan chapter to the Uniform Consumer Credit Code; limits the accrual of additional pawnbroker fees; and makes other technical changes.

OTHER BILLS OF INTEREST

As a part of the Department's continuous monitoring, several bills during the 1999 legislative session have been identified as being of interest to the Department. The following is a list of some of the higher profile bills the Department is tracking. This is not an all inclusive listing. House Bill 1067 – Uniform Prudent Investor Act; House Bill 1431 – Use of money market mutual funds for public fund investment; House Bill 1564 – Credit Union matters; House Bill 1575 – Prohibit automated teller machines on riverboats; House Bill 1589 and Senate Bill 189 – Financial institutions taxation; Senate Bill 355 – Deferred presentment transactions; Senate Bill 369 – Prohibits multiple automated teller machine fees; and Senate Bill 666 – Civil liability for year 2000 problems.

………Kirk Schreiber

WANTED: **YOUR IDEAS, SUGGESTIONS, AND OBSERVATIONS**

We are always striving to improve this newsletter, and listening to our readers' suggestions is one way to accomplish this task. Please, if you have any comments or suggestions, feel free to contact Jim Cooper or Tracy Baker at the addresses or numbers below. We are proud of our state banking system and the people who strive to make it work!

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